Testimony Concerning

"Small Business Renewable Energy Tax Incentive Possibilities,"

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Subcommittee on Contracting & Technology,
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Honorable Nydia M. Velázquez, Chairwoman of the House Committee on Small Business, Ranking Member Chabot and Members of the Committee:

Thank you for inviting me to testify on the tax possibilities for Small Business Renewable Energy.

I have had the opportunity to work in the renewable energy business for over 20 years and to own and operate my own small renewable energy businesses for the past 13 years. I want to start by saying that I am more optimistic about the future of the industry than at any time in my life. When I started working in this industry in Iowa one person could follow all of the projects in the State and understand their technologies. Today we have well over 3.5 Billion dollars worth of ethanol plants, one half Billion dollars worth of Bio-diesel plants and 1.5 Billion dollars worth of wind turbines either in the ground or under construction. I believe we are only scratching the surface of this 21st Century Industry. Many organizations have estimated the jobs and economic development impact on Iowa. For a good description I would refer you to the Union of Concerned Scientist[1] and to the Energy Foundation[2] reports.

While the reasons for supporting renewable energy have always included reducing heavy metals like mercury in the environment, reducing asthma causing particulates in the air, preventing oil wars, slowing global warming, reducing trade imbalances, and protecting God's creation, the motivating issue that seems to have gained the most traction is that of making money. People and companies will put concrete and steel in the ground fastest when they can make money. Tax policy is one of the key mechanisms that enable developers in this industry to make money.

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[1] http://www.ucsusa.org/clean_energy/

[2] http://www.ef.org/programs_news.cfm?program=power

In the energy development business there is no economic level playing field. Fossil fuels have been subsidized for decades in ways too numerous to mention. If we were to internalize all of the costs associated with fossil fuels and pay that price when we turned on the light switch or pay at the pump and we were to incorporate the benefits of developing sustainable energy in the price consumers pay, there is no doubt that sustainable energy would be cost effective today. But unfortunately that is not the world we live in. With that in mind let me briefly lay out some details of how we currently are able to build projects, some of the hurdles and some ideas where incremental tax policy changes might help.

I am currently involved in what we call a Community Owned Wind project.[3] The project consists of ten 2.1 mW wind turbines and 10 mostly farmer owners. These wind turbines cost over 3 million dollars each installed. The electricity is sold to the local Generation and Transmission Cooperative at a very modest price under a long term contract. The turbines are utility scale, state of the art machines each being able to supply enough electricity for 750 homes.

While all sustainable energy development is good and needs to be done rapidly, it is not all equal. For example, energy projects with significant local ownership have been shown to return up to 10 times the economic value to communities as those with typical corporate ownership. Project having typical corporate ownership (vast majority) usually provide a land rental to the local land owner, typically in the range of $2,500 to $4,000 per turbine while the same land owner who owns that turbine could retain $20,000 to $50,000 per turbine annually after debt service. In the renewable energy industry…ownership matters.

Since none of our 10 farmer owners had 3 million dollars in the bank, other money must be brought into the project. This is where tax policy played the largest role. The Section 45 Production Tax Credit is the largest cash flow contributor after the sale of the electricity itself. In order to take advantage of the tax credit and meet the "passive income" constraint, an outside investor must participate in the ownership of the business. This investor must then monetize their contribution to a present value, and hopefully monetize the available accelerated depreciation on capital expense at the same time. "Selling" both of these tax credits by the developer reduces the value of the credits by the amount necessary to incent the new partner to participate. This discount is not taken by larger companies able to use the entire tax credits and depreciation internally and that have passive income appetites.

In addition to bringing in an equity partner, success of our project was dependant on each of the ten LLC's successfully obtaining grant money and loan guarantees under the new Energy Title 9006 Section of the 2002 Farm Bill. This Energy Title has been hugely successful at starting new sustainable energy companies in Iowa and we hope that it will be reauthorized and funded at a much larger amount in the 2007 Farm Bill. The ability of the Section 45 tax credit to offset active as well as passive income would be helpful to our locally owned project development. In addition, money from the USDA program triggers a reduction in the Section 45 tax credit due to a double dipping provision. Elimination of this provision would have a favorable impact on project finance.

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[3] Community owned wind project information can be found at: http://www.c-bed.org/

After bringing in money from the new partner, the Farm Bill, and any State incentives available, a considerable amount of debt is still to be obtained and serviced. Due to the maturing of the industry, local banks are now a ready and willing source of debt funding. This funding is available at market rates. This funding stream may be a place where future tax policy may provide some incentive for small business development. An example might be found in the USDA Farm Service Agency. The FSA offers several programs that "buy down" interest rates for things like Farm Improvements, Beginning Farmers and Financial Setbacks. An interest buy down for renewable energy projects that fit the description of small business or community owned may have significant impact on industry development.

A tax change that could rapidly build our industry would be to provide a tax credit to the electricity off-taker for signing long term contracts with sustainable energy projects that meet the criteria of locally owned. These incentives would need to be at a level that would more than offset the current advantage that the electricity buyer (utility) sees with owning the turbines themselves.

Community ownership of wind lends itself to a more distributed model of electrical generation. This distributed or dispersed placement of generation allows the generation of electricity to be more closely located to the end user. This provides for considerably less transmission line losses as well as greater generation redundancy and hence greater energy generation security. The distributed model also allows for a wider geographic dispersion of wind turbines that take advantage of the fact that the "wind is always blowing somewhere".

A recent study in Minnesota[4] shows that distributed wind generation placed onto the lower voltage "distribution" lines and utilizing existing capacity on those lines could provide for Billions of dollars in new wind turbine placement with very little additional investment in transmission lines. With a lead time of up to seven years for the planning and construction of large transmission lines it seems to make sense that we need to do both immediately. We need to begin planning for large transmission lines while at the same time we need to begin serious construction of distributed wind generation on the smaller distribution grid where capacity allows.

The current cost of conducting the mandatory transmission line integration study for wind projects is prohibitively expensive. The study evaluates the system impact of new generation sources on the transmission grid. Our study for our small group was well over $100,000. This is up-front expense must be conducted with little or no knowledge of outcome nor access to line information. Since the grid owner/operators know this information about their own transmission lines it seems like the outsourcing of this study to outside engineering firms is an excessive upfront expense that unnecessarily reduces development efforts and hinders generation competition. The development of distributed generation systems would be assisted if a mechanism could be found to address this significant hurdle.

[4] http://www.c-bed.org/transmission.html